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5 IN THE UNITED STATES BANKRUPTCY COURT
6 FOR THE DISTRICT OF ARIZONA
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9 In re

10 LOGAN T. JOHNSTON, III,
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13 Debtor.

14 LOGAN T. JOHNSTON, III,

15 Plaintiff,
16

17 v.

18 UNITED STATES OF AMERICA,
19 INTERNAL REVENUE SERVICE

20 Defendant.

Chapter 11

Case No. 2:01-bk-06221-SSC

Adv. No. 2:08-ap-00290-SSC

(For Electronic Docketing Only; Not For
Publication)

**MEMORANDUM DECISION
CONCERNING THE TREATMENT OF
GAP INTEREST IN THE DEBTOR'S
CONFIRMED PLAN**

21 I. INTRODUCTION

22 This matter comes before the Court on a "Complaint for Willful Stay Violation of
23 Discharge Injunction" ("Complaint") filed with the Court on April 17, 2008 by the Plaintiff,
24 Logan T. Johnston, III ("Plaintiff"), which was amended ("Amended Complaint") on April 21,
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1 2008.¹ An “Answer to Amended Complaint for Willful Violation of Discharge Injunction”
2 (“Answer”) was filed on June 26, 2008 by the Defendant, the United States of America²
3 (“Defendant”). After initial proceedings in this matter, the parties filed a Stipulation of Facts on
4 February 13, 2009, and Cross-Motions for Summary Judgment on February 17, 2009.³ This
5 Court conducted oral argument on the Motions on April 16, 2009, and the parties filed post-
6 hearing case citations on a discrete issue. Thereafter the Court took the matter under
7 advisement.

8 Taking into account the arguments of the parties, the documents filed, and the
9 entire record before the Court, the Court has set forth in this decision its findings of fact and
10 conclusions of law pursuant to Fed.R.Civ.P. 52, Bankruptcy Rule 7052. The Court has
11 jurisdiction over this matter, and this is a core proceeding. 28 U.S.C. §§ 1334 and 157 (West
12 2008).

13 II. FACTUAL BACKGROUND

14 On May 14, 2001, the Plaintiff filed a voluntary Chapter 11 petition.⁴ Notice of
15 the Plaintiff’s bankruptcy petition was mailed to all of the Plaintiff’s creditors, including the
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18 **1.** Logan T. Johnston, III, filed his bankruptcy petition on May 14, 2001. As a result,
19 the Bankruptcy Abuse Prevention and Consumer Protection Act of 2005 is not applicable to this
20 matter. In re Reynoso, 477 F.3d 1117, 1120 n.1 (9th Cir. 2007).

21 **2.** In the Answer, the Defendant correctly states that the Internal Revenue Service is an
22 agency of the United States, and as a result, the Plaintiff need only have named the United States
23 as the party against whom he was proceeding. The Plaintiff’s caption refers to the United States
24 and the Internal Revenue Service. The Plaintiff should correct the caption to eliminate the
25 Internal Revenue Service as a party. For purposes of this decision, the Court shall consider the
26 United States as the proper party in interest, and may refer to the United States, the Internal
27 Revenue Service, or the IRS, as appropriate, in its analysis.

28 **3.** The Plaintiff filed a Motion for Partial Summary Judgment, leaving open the issue of
his attorneys’ fees.

4. See Administrative Docket No. 1.

1 Internal Revenue Service (“IRS”).⁵ Thereafter, on June 5, 2001, the IRS filed a proof of claim
2 for income taxes owed by the Plaintiff.⁶ Subsequently, on April 2, 2002, the IRS filed an
3 amended proof of claim.⁷ The IRS’ amended proof of claim listed a total tax claim in the amount
4 of \$125,957.00, of which \$83,823.10 was listed as a priority tax claim.

5 The Plaintiff filed his Plan of Reorganization on January 16, 2002, followed by
6 his Disclosure Statement on February 1, 2002.⁸ The Plaintiff also filed an Amended Plan of
7 Reorganization (“Amended Plan”) on February 1, 2002.⁹ On February 26, 2002, the Court held
8 a hearing regarding the Plaintiff’s Disclosure Statement. No objections were presented at the
9 hearing, and the Court, having found adequate information in the Disclosure Statement, entered
10 an order approving the Disclosure Statement (“Disclosure Order”) on February 27, 2002.¹⁰ The
11 Disclosure Order required that a creditor file an acceptance or rejection to the Amended Plan by
12 March 8, 2002. The Defendant concedes that it received (1) the notice of the Disclosure
13 Statement, the Amended Plan, and the Disclosure Order and (2) a ballot to accept or reject the
14 Plaintiff’s Amended Plan.

15 On March 30, 2005, the Court issued its Order of Confirmation, which provided
16 for confirmation of the Plaintiff’s Amended Plan, with modifications not relevant to this
17 adversary.¹¹ The IRS never filed an objection to confirmation, did not file any post-confirmation

18 **5.** See Docket No. 19, Page 2, ¶ B.

19 **6.** See Docket No. 19, Page 2, ¶ C.

20 **7.** Id.

21 **8.** See Administrative Docket Nos. 52, 54.

22 **9.** See Administrative Docket No. 55.

23 **10.** See Administrative Docket No. 62.

24 **11.** Because it was a contested confirmation hearing, the Court entered its Memorandum
25 Decision in the matter on March 30, 2005. See Administrative Docket No. 290. The Court
26 entered an Order Incorporating Memorandum Decision, which provided for confirmation of the
27 Debtor’s Amended Plan (the “Confirmation Order”) on March 30, 2005. See Administrative

1 motions concerning the contested confirmation hearing, and did not appeal the Confirmation
2 Order.

3 Pursuant to the Amended Plan, the Plaintiff paid the IRS' priority tax claim of
4 \$83,823.10 on or about October 4, 2005. The parties have stipulated, for purposes of the issues
5 now presented, that between June 5, 2001 and April 2006, they never discussed the Amended
6 Plan or what effect confirmation of the Amended Plan would have on the IRS' priority tax
7 claim.¹²

8 According to the IRS, between the petition date of May 14, 2001 and the
9 confirmation date of March 30, 2005, interest in the amount of \$19,612.87 had accrued on the
10 priority tax debt. In April of 2006, the IRS began sending the Plaintiff letters in an effort to
11 collect this accrued interest. In response to these letters, the Plaintiff, believing that such interest
12 had been discharged, filed this adversary proceeding.

13 14 III. DISCUSSION

15 A. Sovereign Immunity

16 The United States, as a sovereign, is immune from suit unless it consents to being
17 sued. United States v. Shaw, 309 U.S. 495, 500-01, 60 S.Ct. 659, 661, 84 L.Ed. 888 (1940);
18 Gilbert v. DaGrossa, 756 F.2d 1455, 1458 (9th Cir. 1985); Hutchinson v. United States, 677 F.2d
19 1322, 1327 (9th Cir. 1980). Consent, through waiver of its right to sovereign immunity, must be
20 "unequivocally expressed." United States v. King, 395 U.S. 1, 4, 89 S.Ct. 1501, 1502, 23
21 L.Ed.2d 52 (1969). Pursuant to 26 U.S.C. § 7433(e), Congress has conditionally waived

22 _____
23 Docket No. 291. For purposes of this Decision, the Court shall refer to all of these documents as
24 the "Confirmation Order." It is important to remember that the Plaintiff had to resolve a number
25 of objections to the confirmation of his Amended Plan and had to conduct a contested hearing on
26 confirmation concerning the objection to confirmation filed by his ex-spouse, Ms. Paula Parker.
As a result, the confirmation process took longer than expected, allowing any creditor or
interested party ample opportunity to alert the Court of any noticing issues or problems
associated with the Plaintiff's Amended Plan.

27 **12.** See Docket No. 19, Page 2, ¶ I.

sovereign immunity when an officer or employee of the IRS willfully violates Section 362 or Section 524. *See also* Kuhl v. United States, 467 F.3d 145, 147 (2d Cir. 2006). However, in order to obtain damages under 26 U.S.C. § 7433(e), the debtor must first exhaust the administrative remedies available within the IRS. 26 U.S.C. § 7433(d)(1). The party bringing suit bears the burden of showing an unequivocal waiver of sovereign immunity. Vacek v. U.S. Postal Serv., 447 F.3d 1248, 1250 (9th Cir. 2006).

The Complaint in this case named two defendants in this matter: the United States of America and the IRS. The United States, in a footnote within one of its pleadings, indicates that the Internal Revenue Service, as an agency of the United States, is protected by sovereign immunity and cannot be sued in the absence of Congressional authorization. Gilbert v. DaGrossa, 756 F.2d 1455, 1458 (9th Cir. 1985). However, in its Motion for Summary Judgment, the United States regards the reference to the IRS in the Complaint, and other pleadings, as a clarification regarding which agency of the United States was involved in the dispute with the Plaintiff. Moreover, the United States did not assert the IRS' right to sovereign immunity within its Answer, and counsel for the United States appeared at the hearing in this matter. The IRS also filed a proof of claim in this matter, which acts as a waiver to sovereign immunity. 11 U.S.C. § 106(b). Accordingly, the Court finds that the issue of sovereign immunity was never effectively argued, raised, or presented to the Court; therefore, for purposes of this decision, the Court will consider the United States, and the IRS, as its agency, to have waived the issue of sovereign immunity and will turn to the merits of the controversy between the parties.

B. The Treatment of Gap Interest

The Bankruptcy Code exempts from discharge all allowed unsecured claims for income taxes in a tax year ending on or before “three years before the date of the filing of the [bankruptcy] petition.” 11 U.S.C. §§ 507(a)(8), 523(a)(1). Although creditors are generally not allowed to include unmatured interest as part of their claims, it is well settled that interest continues to accrue on a nondischargeable debt during the “gap” between the petition filing date

1 and the date upon which a plan is confirmed. This accrued interest, called “gap interest”
2 because of the time-frame in which it arises, is also nondischargeable. In re Artisan
3 Woodworkers, 225 B.R. 185, 191 (9th Cir. BAP, 1998); Bruning v. United States, 376 U.S. 358,
4 84 S.Ct. 906, 11 L.Ed.2d 772 (1964); *See also* 11 U.S.C. § 502(b)(2).

5 While the Plaintiff’s Amended Plan includes the payment, in full, of Defendant’s
6 unsecured priority tax claim, the parties dispute whether the Amended Plan also treats the gap
7 interest associated with this claim. The Defendant argues that the Amended Plan is ambiguous
8 as to the treatment of the gap interest because certain language within the Disclosure Statement
9 is less precise or contradicts the language contained within the Amended Plan. Conversely, the
10 Plaintiff argues that the Amended Plan is clear on its face, and the Disclosure Statement is a
11 separate document that is not incorporated into the Amended Plan unless there is a specific
12 statement so providing.

13 The Plaintiff primarily relies on Articles IV and VI within his Amended Plan to
14 support his position that the gap interest has been discharged. The Articles provide as follows:

15 ARTICLE IV

16 All impaired classes of claims and interests shall receive the
17 distributions set forth in this Article on account of and in complete
18 satisfaction of all such Allowed Claims (and any interest accrued
19 thereon) and Allowed Interests. Without limiting the foregoing
20 and effective upon the Effective Date, each creditor and each
21 equity security holder (or its successor) shall be deemed to have
22 assigned to the Debtor and all such parties shall be deemed to have
23 waived, relinquished and released any and all of their rights and
24 claims against the Debtor (other than as provided for in the Plan or
25 the Court’s order confirming the Plan).

26

27 **Class 6: Priority Tax Claims**

28 The [IRS’] priority taxes will be paid in deferred cash
payments in the allowed amount of the claims within six years of
the date of assessment under § 1129(a)(9)(C).

29 ARTICLE VI

30 Except as otherwise provided in the Plan or in the Court’s order
31 confirming the Plan, . . . the Confirmation Order acts [as] a
32 discharge, effective as of the Effective Date, of any and all debts of
33 the Debtor that arose at any time before the entry of the

1 Confirmation Order, including, but not limited to, all principal and
2 any and all interest accrued thereon, pursuant to § 1141(d)(1) of
3 the Bankruptcy Code.

4 The Court must first determine whether the Amended Plan, as the Debtor contends, is clear in its
5 treatment of the gap interest, or whether, as the IRS argues, the Amended Plan is ambiguous. In
6 order to make such a determination, the Court will review Articles IV and VI seriatim.

7 Article IV of the Amended Plan begins by stating that the distributions made to
8 the impaired classes of creditors will constitute “complete satisfaction” of those classes’ claims.
9 The Defendant argues that it is not an impaired creditor, and that as such, Article IV does not
10 pertain to it. The Court disagrees. Under Ninth Circuit law, a claim is impaired if such claim is
11 altered in any way under the plan. L & J Anaheim Assoc. v. Kawasaki Leasing Int’l (In re L &
12 J Anaheim Associates), 995 F.2d 940 (9th Cir. 1993).

13 In this case, the Defendant’s claim was altered in several material ways. First,
14 under the terms of the Amended Plan, the Defendant was to be paid on its claim over time,
15 pursuant to 11 U.S.C. § 1129(a)(9)(C). At the time of confirmation, that Subsection provided as
16 follows:

- 17 (a) The court shall confirm a plan only if . . . –
18 (9) Except to the extent that the holder of a particular
19 claim has agreed to a different treatment of such claim,
20 the plan provides that –
21 (C) with respect to a claim of a kind specified in
22 section 507(a)(8) . . . the holder of such claim
23 will receive on account of such claim deferred
24 cash payments over a period not exceeding six
25 years after the date of assessment of such claim,
26 of a value, as of the effective date of the plan,
27 equal to the allowed amount of such claim.¹³

28 Even if the payment of principal over time, pursuant to that Subsection, would not be considered
impairment, the Plaintiff altered the Defendant’s claim by not paying any interest thereon.

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27 **13.** Since the case was filed prior to the enactment of BAPCPA, the Court has utilized
the statutory language that was applicable at the time of confirmation.

1 Accordingly, the Court finds that the Defendant's claim was impaired and, therefore, within the
2 parameters of Article IV. As such, the IRS waived any additional rights and relinquished and
3 released any additional claims that it had against the Plaintiff. Such a waiver of rights or release
4 of claims includes the IRS' right to gap interest.

5 Article IV further provides that all creditors are deemed to have assigned their rights
6 to the Plaintiff, and that said assignment constitutes a "waive[r], relinquish[ment] and release[]
7 [of] any and all of [the creditors'] rights and claims against the [Plaintiff]." Thus, even if the
8 Defendant's right to gap interest somehow still survived irrespective of the initial language in
9 Article IV, the remaining provisions in the Article clearly assign those rights to the Plaintiff.
10 Effectively the Defendant transferred its right to gap interest to the Plaintiff.¹⁴ As such, the
11 Plaintiff has shown a separate ground for the impairment of the Defendant's claim.

12 Article VI of the Amended Plan next states, and in the case of impaired classes
13 reiterates, that upon plan confirmation, as evidenced by the entry of the Confirmation Order, the
14 principal and interest on all debts, except as treated pursuant to the Amended Plan or the
15 Confirmation Order, are discharged pursuant to 11 U.S.C. § 1141(d)(1). At the time of
16 confirmation, Subsection (d)(1) provided as follows:

17 Except as otherwise provided in this subsection, in the plan, or in
18 the order confirming the plan, confirmation of the plan –

- 19 (A) discharges the debtor from any debt that arose
20 before the date of such confirmation . . . whether or
21 not –
22 (i) a proof of the claim based on such debt is filed
23 or deemed filed under section 501 of this title;
24 (ii) such claim is allowed under section 502 of
25 this title; or
26 (iii) the holder of such claim has accepted the plan
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26 **14.** Thus, the impairment of the Defendant's claim is reflected in the Plaintiff's failure to
27 provide for any payment of interest to the Defendant and the separate assignment of any such
28 interest to the Plaintiff.

1 In referring specifically to Section 1141(d)(1), the Plaintiff was alerting creditors that the
2 provisions of 11 U.S.C. § 1141(d)(2) did not apply to their claims. At the time of confirmation,
3 Section 1141(d)(2) provided that the confirmation of a plan did not discharge an individual
4 debtor from any debt excepted from discharge under Section 523. This is an important
5 distinction.¹⁵ The Plaintiff drafted Article VI in a manner to alert creditors, in a clear manner,
6 that unless the Amended Plan or the Confirmation Order was specifically changed, the entry of
7 the Confirmation Order would discharge all debts of the Plaintiff, whether for principal or
8 interest, and whether dischargeable or nondischargeable. In this case, the Confirmation Order
9 was not amended to protect the rights of the Defendant, and the Defendant did not appeal the
10 Order.

11 Based upon the foregoing, the Court concludes that Articles IV and VI of the
12 Amended Plan were clear and alerted the Defendant that its claim was impaired, either because
13 of the Plaintiff's failure to pay gap interest or because of the assignment of the Defendant's
14 rights to the Plaintiff, and that the Defendant needed to take action to protect its right to gap
15 interest. Because the Defendant took no timely action to protect its right to gap interest, the debt
16 was discharged.

17 The Defendant next argues that even if the Amended Plan is not ambiguous and
18 Articles IV and/or VI clearly apply, the Court must look beyond the Amended Plan to the
19 Disclosure Statement, which is ambiguous and states only that all debts are to be discharged
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23 **15.** In a case factually similar to this case, the debtor attempted to discharge the IRS'
24 debt with the inclusion of a broad clause that released all debt pursuant to "11 U.S.C. § 1141."
25 See Miller v. United States, 363 F.3d 999 (9th Cir. 2004). Because the debtor did not specify any
26 particular Subsection, such as (d)(1), the Ninth Circuit concluded that the general reference to
27 Section 1141 was ambiguous, and reconsidered the IRS' argument that gap interest was excepted
from discharge under 11 U.S.C. §§ 1141(d)(2) and 523. Id. The Plaintiff's counsel stated at oral
argument before this Court that the Miller decision was of concern to him and prompted him to
specifically include Section 1141(d)(1) in the Amended Plan.

1 pursuant to “11 U.S.C. § 1141.”¹⁶ The Defendant essentially advances the argument that a plan
2 and a disclosure statement form one document that must be read together. If the disclosure
3 statement contains an ambiguity, that ambiguity must necessarily be incorporated into the plan.

4 The Ninth Circuit has held that “a Chapter 11 bankruptcy plan is essentially a
5 contract between the debtor and his creditors, and must be interpreted according to the rules
6 governing the interpretation of contracts.” Miller v. United States, 363 F.3d 999, 1004 (9th Cir.
7 2004) *citing* Hillis Motors, Inc. v. Haw. Auto. Dealers Ass’n, 997 F.2d 581, 588 (9th Cir. 1993).
8 As to the applicable law in interpreting such a contract, since the Plaintiff was a resident of
9 Arizona at the time of filing of his bankruptcy petition and otherwise met the venue
10 requirements, the Court should analyze the law of Arizona in resolving this dispute.

11 The general rule, under Arizona law, for one document to incorporate another
12 writing is that the incorporating document must clearly indicate such an intent. Weatherguard
13 Roofing Co. V. D.R. Ward Const. Co., 152 P.3d 1227, 1229 (Ariz. App. 2007). In reviewing
14 the Amended Plan, there is no reference to the Disclosure Statement, nor is there any statement
15 in the Amended Plan to evidence an intent to incorporate the Disclosure Statement.
16 Furthermore, the language of the Disclosure Statement clearly states that should there be any
17 inconsistency between the terms of the Amended Plan and the terms of the Disclosure Statement,
18 the language of the Amended Plan is controlling.¹⁷ Moreover, the Confirmation Order only
19 refers to the Amended Plan, not to the Disclosure Statement. Thus, the critical document for the
20 Court’s interpretation of the rights and remedies of the parties should be the Amended Plan,
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23 **16.** Presumably such an ambiguity would allow the Defendant to rely on the decision of
24 Miller v. United States, *supra* n.14, to argue that this Court should reconsider whether the gap
interest was discharged.

25 **17.** See Administrative Docket No. 54, Page 3, ¶¶ 1-3. The Court also conducted several
26 hearings on the Disclosure Statement. See Administrative Docket Nos. 61, 62. Presumably any
27 ambiguities or requests to have the Disclosure Statement incorporated into the Amended Plan
should have been taken care of at that time.

1 which return the Court and the parties to the provisions of Articles IV and VI already analyzed
2 by the Court.

3 The Court concludes that the Defendant's alternative theory is incorrect, and the
4 Amended Plan did not incorporate the Disclosure Statement. Accordingly, the Amended Plan
5 effectively discharged the Defendant's claim to gap interest.¹⁸

7 IV. CONCLUSION

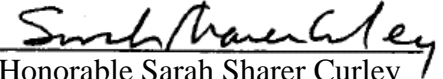
8 The Court finds that to the extent that the United States may have had a defense
9 based upon sovereign immunity, such defense was waived both by the appearance of counsel at
10 the hearing as well as the filing of its proof of claim. Furthermore, the Court finds that the
11 Amended Plan is clear as to its treatment of the Defendant's gap interest. Finally, the Court
12 finds that the Disclosure Statement was not incorporated into the Amended Plan. Based upon
13 the foregoing, the Court holds that the gap interest was discharged pursuant to the Debtor's
14 Amended Plan.

15 The Court must set a further hearing to determine whether the Defendant has
16 separately violated the Plaintiff's discharge injunction and whether, if such a violation has
17 occurred, the Plaintiff is entitled to attorneys' fees. The Plaintiff's Motion for Partial Summary
18 Judgment is granted, and the Defendant's Motion for Summary Judgment is denied. The Court
19 will enter an order incorporating this decision. A separate notice will be issued by the Clerk's
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21 **18.** Although the parties discussed the Ninth Circuit's recent holding in Espinosa v.
22 United Student Aid Funds, Inc., 553 F.3d 1193 (9th Cir. 2008), they believe the decision to be
23 inapplicable to the facts in this case. Moreover, since the decision allowed a student loan
24 obligation, also a nondischargeable debt within the parameters of Section 523, to be discharged
25 pursuant to the provisions of the duly noticed plan without the commencement of an adversary
26 proceeding, it supports the argument of the Plaintiff that the Amended Plan controls the
27 treatment of the Defendant's gap interest claim. Furthermore, presumably based upon Espinosa,
the Defendant conceded that if the Court found the Amended Plan unambiguous, and did not
incorporate the Disclosure Statement into the Amended Plan, the Defendant's claim for gap
interest would be discharged. Having found the Amended Plan language unambiguous, this
Court has completed its analysis.

1 Office scheduling a Bankruptcy Rule 7016 conference on the remaining issues in this adversary.
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4 DATED this 30th day of July, 2009.

5 
6 Honorable Sarah Sharer Curley
7 U. S. Bankruptcy Judge
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